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Taxes in the area of foreign securities offerings in the United States are pretty straightforward and not nearly as detailed and controversial as the other issues that have been addressed in the Conference today.

These tax issues fall into a couple of categories.

The primary concern, from the marketing perspective, in the sale of non-U.S. securities in the United States, is the foreign taxes, not the U.S. taxes. That is, what are the consequences to a U.S. investor purchasing these securities, whether they produce dividends, interest, or capital gains; how is that income going to be taxed in the foreign jurisdiction, albeit a tax on the debtholder or the securityholder?

The foreign tax exposure primarily arises in the form of withholding taxes. How does the host country treat a dividend payment paid to a non-resident (*i.e.*, a resident of the United States) or treat an interest payment being made?

Those consequences range from bad consequences to perhaps some good consequences. On the bad side, there would be a withholding tax. Sometimes the withholding tax is an actual tax that the U.S. investor has to suffer, which is a cost of holding a non-U.S. investment. Other times, the form of withholding tax may be neutral, either because the issuer agrees to gross-up (*i.e.*, compensate) the U.S. investor for the foreign withholding tax; or perhaps by an income tax treaty between the host country and the United States that reduces the withholding tax to zero.[1]

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1. *See, e.g.*, The Convention Between the United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, S. TREATY DOC. No. 6, 103d Cong., 1st Sess., 1993, *reprinted in* 31 I.L.M. 462 (1993) [hereinafter U.S.-Neth. Tax Treaty]; The Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with

At the other extreme are the benefits. Sometimes there are benefits to U.S. investors of holding the foreign securities. That produces a positive tax arbitrage, to use an attractive word. For example, a U.S. investor holding a U.K. equity issue, receives not only the dividend but also a refund, an incremental addition to the coupon or the dividend, based upon the method of taxing used in the United Kingdom. So there actually is a benefit, an inducement, to holding that security.

All of these foreign taxes, although suffered or perhaps grossed-up to the U.S. investor, are eligible for a foreign tax credit in the United States.[2] That is, even though the actual yield may be reduced on the payment to the U.S. investor, the U.S. investor is eligible to claim a foreign tax credit against his U.S. tax liability for these amounts.

The opportunity to claim this tax credit, I think, from a marketing point of view is not very attractive. Often it's simply too difficult for the individual investor to try to substantiate or document the claimed credits. As we heard this morning, one of the attractions of the American Depositary Receipt ("ADR") facility, as opposed to a direct holding, is that some of these headaches are handled by the ADR facility and not imposed upon the investor herself or himself.[3]

The key to wading through the withholding taxes is obviously the tax treaty network. That is, the United States has negotiated many bilateral income tax treaties with foreign countries.[4] These treaties often pave the way for international securities of-

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Respect to Taxes on Income and Capital and to Certain Other Taxes, S. TREATY DOC. No. 10, 101st Cong., 2d Sess., 1990, *reprinted in* 2 Tax Treaties (CCH) ¶ 3249, at 28,151 [hereinafter U.S.-F.R.G. Tax Treaty].

2. I.R.C. § 901 (1993). Section 901 states that a taxpayer with income from non-U.S. sources may receive a credit against U.S. taxes for any taxes paid on such income in the non-U.S. jurisdiction. *Id.* This foreign tax credit is limited by Section 904, which provides,

> (a) Limitation.—The total amount of the credit taken under section 901(a) shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

I.R.C. § 904(a) (1993).

3. *See* Joseph Velli, *American Depositary Receipts: An Overview*, 17 FORDHAM INT'L L.J. S38, S56-57 (1994) (discussing role of depositary bank).

4. *See, e.g.*, U.S.-Neth. Tax Treaty, *supra* note 1; U.S.-Germ. Tax Treaty, *supra* note 1.

ferings by relaxing local tax laws that would make such an offering prohibitive from a U.S. investor's point of view. A good example of that is the recent tax treaty with Mexico, which when it comes into effect, will make an investment by a U.S. investor far more attractive than under current Mexican law.[5]

In addition to the foreign withholding tax issue, there are also a variety of structural issues. From the debt side, there are tax rules that limit the ability of the U.S. investors to purchase bearer obligations; that is, debt obligations that are not in registered form but issued only in bearer form.

Many times a global offering of securities — an Australian company or a Mexican company that is trying to issue securities throughout the world — must have two tranches, that is two separate instruments: one that targets to U.S. investors, satisfying the requirements of registered form; and, a second level of securities or obligations that may be issued in bearer form, which is the more customary form of issuing such securities throughout the world. Briefly, you cannot issue bearer obligations in the United States. However, there are exceptions, but that is for another day and another seminar.

From a tax point of view, ADRs are very straightforward. You do not own the security, you own a receipt that evidences ownership of the security.[6] For tax purposes, you ignore the ownership of the receipt; you are treated as the owner of the underlying security. If there is a withholding tax, tax credits are available. There is obviously a currency risk in the underlying security. All of those flow directly to the securityholder.

Finally, in many cases there are overseas tax advantages to having the securities issued by an intermediary company, a conduit — sometimes a controlled conduit, sometimes a more artificially established conduit — that either avoids withholding taxes in the host country, making the obligation or the security more attractive to the U.S. market, or perhaps tries to take advantage of some imbalance between the two countries' laws producing a "double-dip" or some peculiar type of tax advantage in the foreign country. Those conduits need to be watched. They are

5. The Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, S. TREATY DOC. No. 7, 103d Cong., 1st Sess., 1993, *reprinted in* 2 Tax Treaties (CCH) ¶ 5903, at 35,807.

6. *See* Velli, *supra* note 3, at S39-40 (discussing operation of ADR programs).

clearly tax-advantaged obligations from the issuer's point of view. It is often just a question of time before either the host country or the United States catches up to the issuance through conduits, and what may look like a good structure one year may not be such an acceptable structure another year.

You have to keep track of the tax laws relating to those conduits. Canada, for example, has been very aggressive in the last few years in attacking conduit issuers. Even the United States, as part of the last tax act, now has a provision that says the Internal Revenue Service ("IRS") has the discretion to disregard a conduit where the IRS considers that conduit to have been structured for tax avoidance purposes, as opposed to more legitimate business purposes.[7]

Perhaps the classic conduit fear in the United States is the risk of having your foreign issuer be treated as a passive foreign investment company ("PFIC").[8] From a corporate lawyer's point of view, the PFIC risk is something they have the tax lawyers draft and hopefully don't have to understand. This is not the time to go into the details of the PFIC rules. Suffice it to say, not all conduits are attractive from a U.S. investor's point of view.

In summary, the tax aspects of the international securities offerings should not become the major issue. Contrary to what

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7. I.R.C. § 884(e)(4)(D) (1993). Section 884(e)(4)(D) provides,

> (D) Secretarial Authority.—The Secretary may, in his sole discretion, treat a foreign corporation as being a qualified resident of a foreign country if such corporation establishes to the satisfaction of the Secretary that such corporation meets such requirements as the Secretary may establish to ensure that individuals who are not residents of such foreign country do not use the treaty between such foreign country and the United States in a manner inconsistent with the purposes of this section.

Id. Section 884 imposes a branch profits tax, equivalent to the withholding tax on an equal amount of dividend, on the repatriation of profits of a branch of a U.S. corporation by the corporation. I.R.C. § 884 (1993). Often, such a business structure is used in an attempt to avoid the applicable withholding tax on dividend payments by foreign subsidiaries to their U.S. parents.

8. I.R.C. § 1296 (1993). Section 1296 defines a PFIC as,

> any foreign corporation if—
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> (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or
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> (2) the average percentage of assets (by value) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent.

Id. Section 1291 eliminates the advantage of tax deferral for shareholders in PFICs by applying an interest charge on any previously undistributed (and untaxed) share of the PFIC's earnings at the time of eventual distribution. I.R.C. § 1291 (1993).

our luncheon speaker said in his brief comparison of fees that result from these transactions, the tax advice should not add greatly to the fee of an international securities offering. If anything, tax treatment represents only a disclosure obligation, which is usually a disclosure of foreign tax consequences. There are very few U.S. tax concerns that rise to the level of significantly altering securities offerings.

From an advisory point of view, the tax lawyers or tax advisers are pretty much on the sidelines for these types of obligations. Obviously, the players in the middle of the field are the accountants trying to get through the reconciliation requirements and the securities lawyers and the underwriters attempting to satisfy the far more detailed requirements that you heard much more about today.[9]

9. *See* William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective*, 17 FORDHAM INT'L L.J. S10, S20-21 (1994) (discussing key players in offering of non-U.S. securities in United States); Frode Jensen, III, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From a Legal Perspective*, 17 FORDHAM INT'L L.J. S25, S34 (1994) (discussing role of management in preparing non-U.S. company for registration in United States).